



PASS-THROUGH ENTITIES

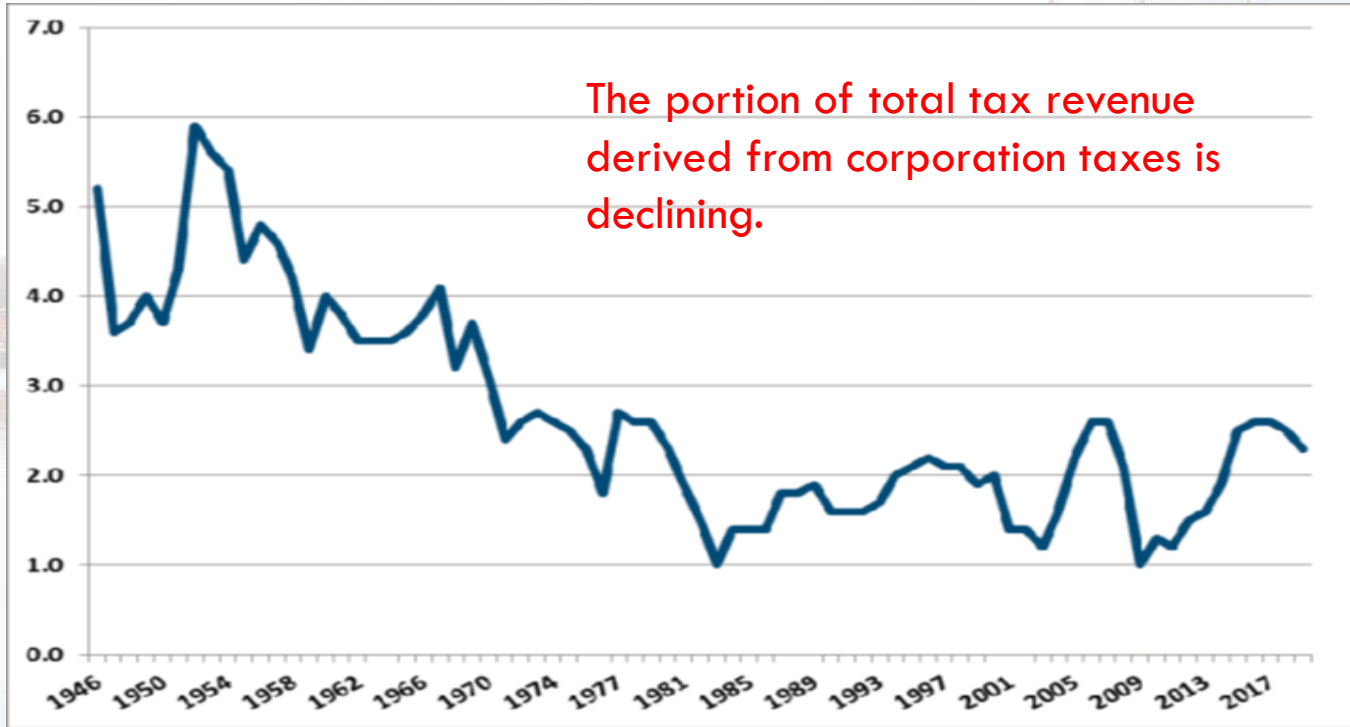
Time to Take Notice

Joseph Milack, FAST Enterprises

Objective

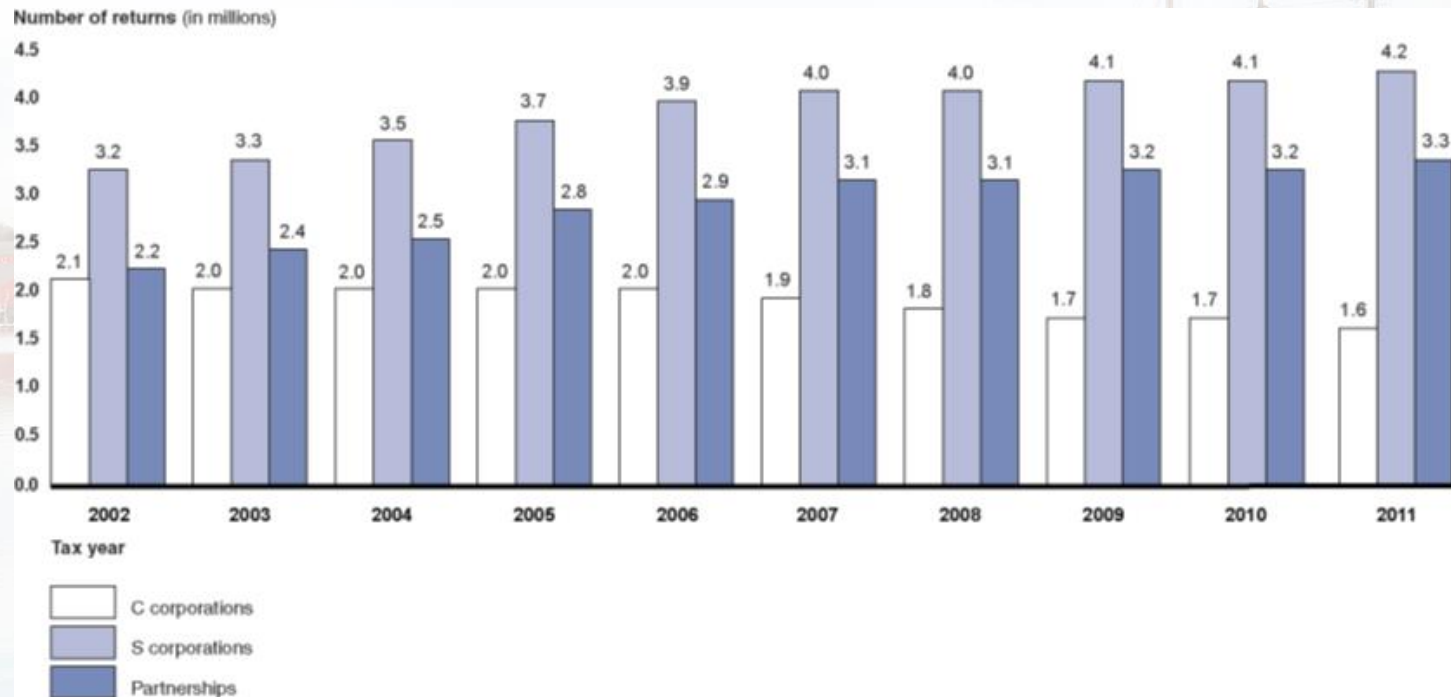
- Provide a perspective on the increase in the number and size of pass-through entities
- The unique compliance issues
- The compliance/enforcement response
- How revenue agencies audit pass-through entities
- What we do not know and need to address
- Discussion and different perspectives
- Relevant system capabilities/role of analytics

Corporate Tax Revenue as a Percentage of GDP, 1946-2019



Source: The Corporate Income Tax System: Overview and Options for Reform,
Congressional Research Service, December 1, 2014

Number of Returns by Entity Type



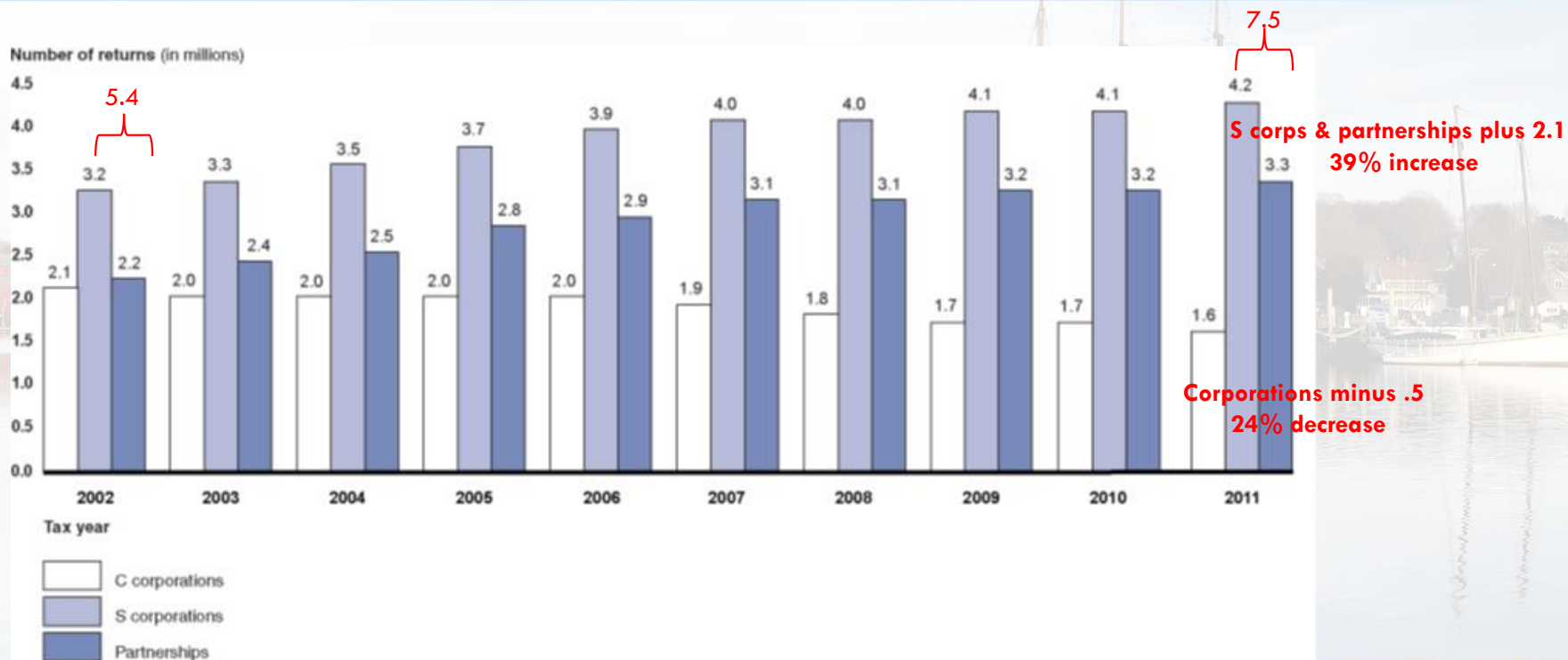
Source: GAO analysis of IRS data. | GAO-14-732

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Number of Returns by Entity Type



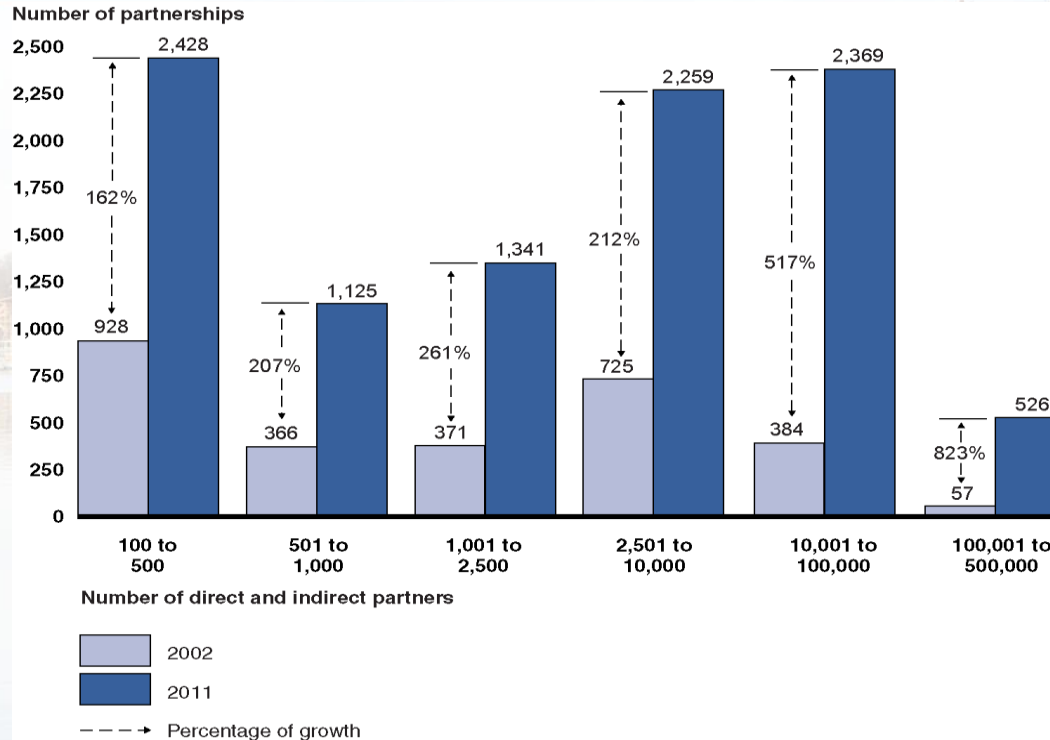
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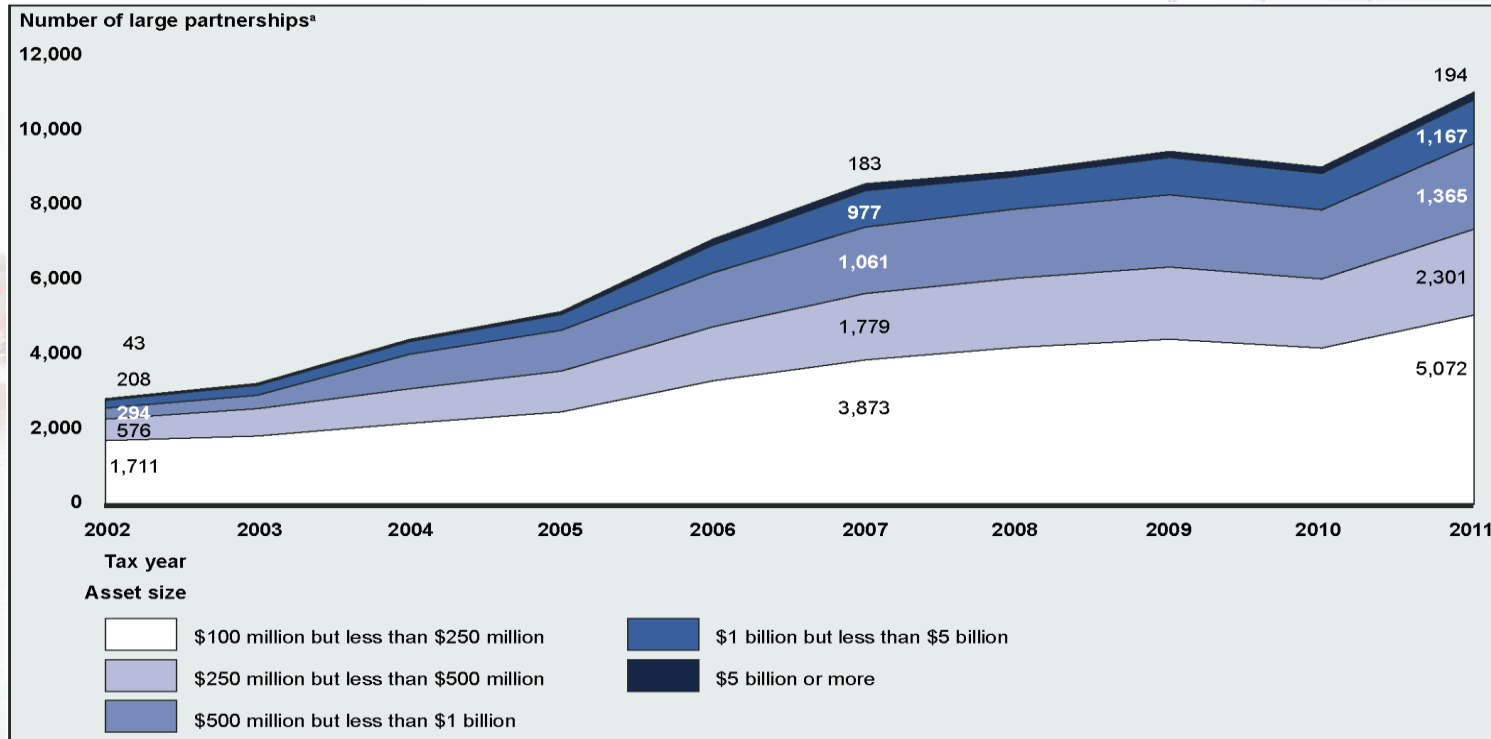
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Direct and Indirect Partners



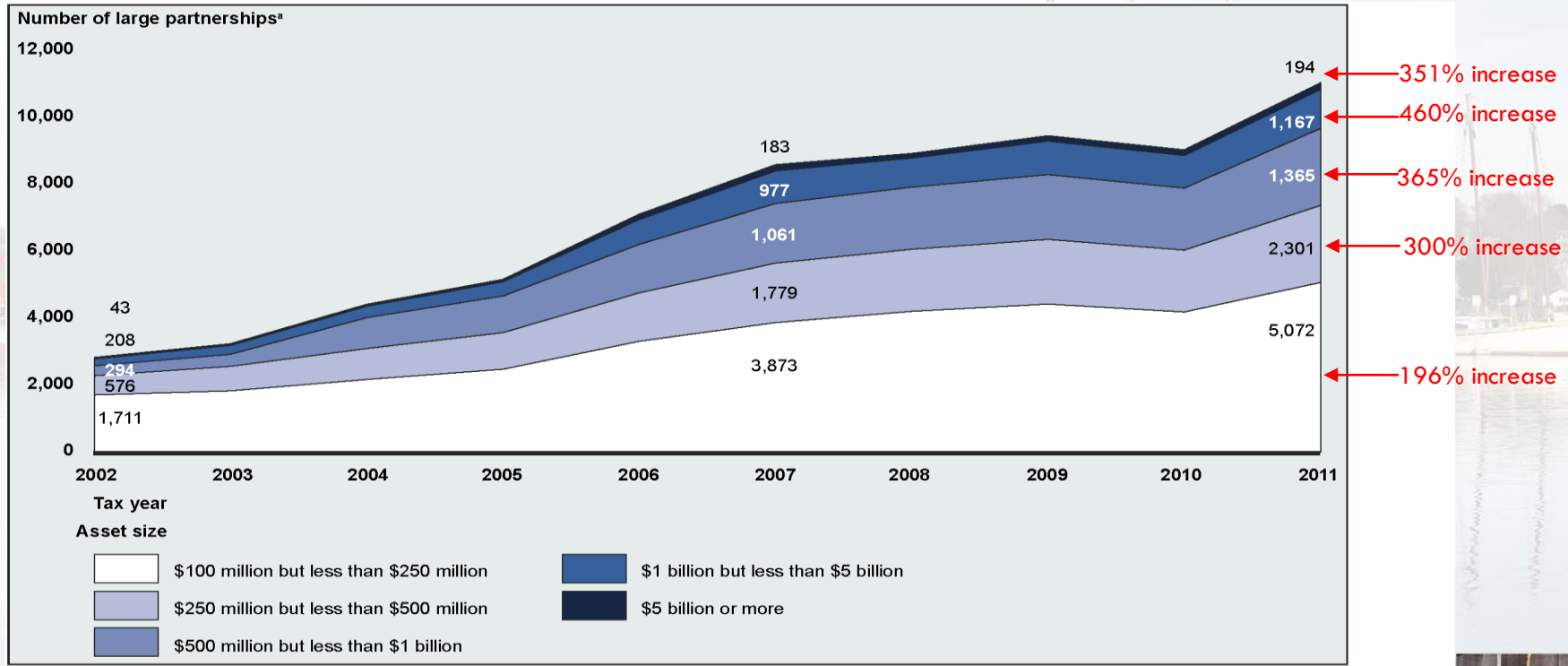
Source: GAO analysis of IRS data from Enhanced Large Partnership Indicator File and Business Returns Transaction File, Compliance Data Warehouse. | GAO-14-732

Large Partnerships by Asset Size



Source: GAO analysis of IRS data from Enhanced Large Partnership Indicator File and Business Returns Transaction File, Compliance Data Warehouse. | GAO 14-732

Large Partnerships by Asset Size



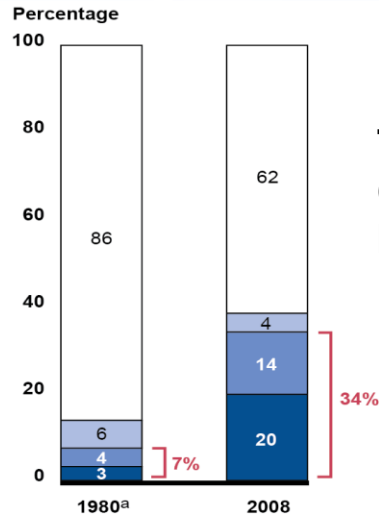
Source: GAO analysis of IRS data from Enhanced Large Partnership Indicator File and Business Returns Transaction File, Compliance Data Warehouse. | GAO 14-732

Large Partnerships by Industry Groups

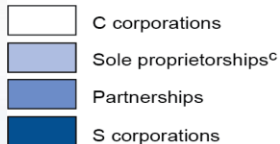
Industry Group	Tax Year									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Mining	18	32	35	44	76	99	131	129	127	170
Manufacturing	23	25	27	39	56	85	105	108	116	142
Transportation and Warehousing	43	43	51	40	56	61	92	87	96	114
Finance and Insurance	1,799	2,195	2,715	3,190	4,731	5,707	5,530	6,124	5,955	7,333
Real Estate, Rental, and Leasing	695	685	782	870	1,081	1,275	1,486	1,401	1,287	1,507
Professional, Scientific, and Technical Services	55	57	69	74	85	86	108	109	98	129
Holding Companies	56	53	72	89	113	157	186	200	193	233
Other	143	152	198	256	320	403	446	442	387	471

Source: GAO analysis of IRS data from the Enhanced Large Partnership Indicator (ELPI) File and Business Returns Transaction File, Compliance Data Warehouse. | GAO-14-732

Gross Receipts



Dollars (in trillions)^b \$15.7 \$32.8

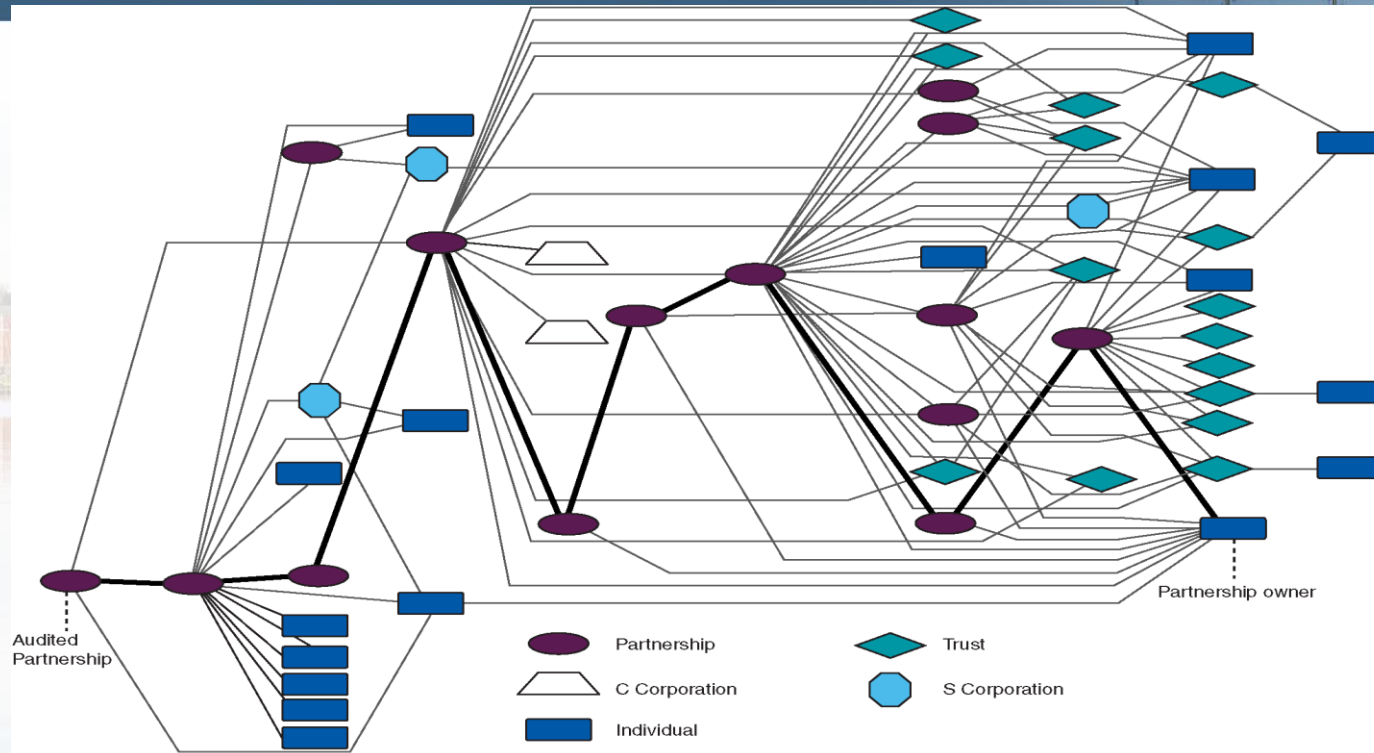


Source: GAO analysis of IRS data.

The Share of Gross Business Receipts by Partnerships and S Corporations Grew from about 7 Percent to about 34 Percent between Tax Year 1980 and Tax Year 2008

“Using this information, and considering various caveats and uncertainties, we estimated a rough order of magnitude of the misreporting to be \$91 billion per year for tax years 2006 through 2009.”

Example of Partnership Structure



Source: GAO analysis of IRS documentation. | GAO-14-732

Observations

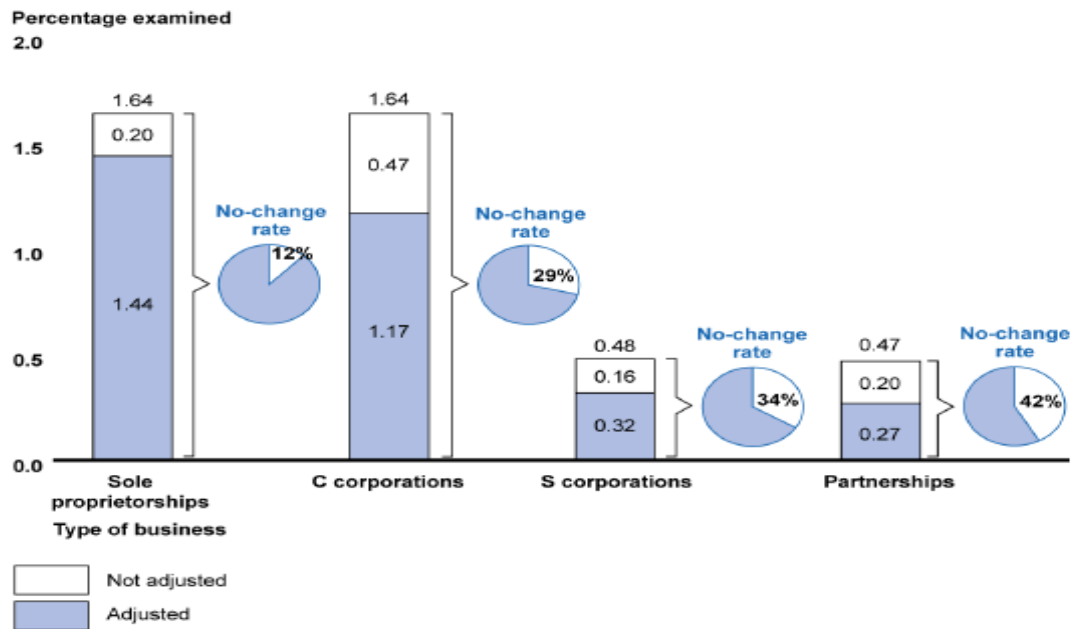
- The number and complexities of pass-through entities is growing
- Pass-through entities are taking on a larger role in economic activity
- Revenue agency programs are focused more on selecting and auditing corporate entities **rather than** pass-through entities
- The pace of compiling data to support audit selections and analytics is constrained by past practices and priorities

Audit Selection and Data Analytics

- At present, it is limited to data queries
- Constrained by lack of historical data and adequate repository of audit results
 - Too few completed audits to support predictive modeling and other data driven selection methods
- Limited insight into how to “segment” population of pass-through entities
 - Size of entity
 - Business activity
 - Number of partners/members
- Failure to put in place the structure to identify and capture the data now in order to introduce data analytics in the future
 - What data is needed for audit selection
- Too few experienced, expert business users to provide necessary insight to support advance audit selection and modeling approaches

IRS Audit Adjustment Rates

Figure 5: Fiscal Year 2012 Examination and Adjustment Rates for Different Types of Tax Returns



Source: IRS.

IRS Average Proposed Audit Adjustments

Table 2: Average Proposed IRS Adjustment to Income for Partnership and S Corporation Revenue Agent Examinations, Fiscal Year 2012

IRS division	Proposed adjustment per tax return	
	Partnerships ^a	S corporations
Small Business/Self-Employed	\$126,867	\$90,409
Large Business and International	\$5,292,472	\$484,751

Source: GAO analysis of IRS data.

Current Audit Approaches

- Matching K-1 (IRMF), partnership return, etc. to identify partner/member nonfiling/not reporting K-1 income
 - This may or may not include capturing K-1 data from state returns
- Business tax units audit the entity and then pass the entity audit results to other units (i.e. individual income tax audit) to assess the partners/members
- One audit unit audits the entity and computes the additional liabilities associated with partners/members

Conclusion

- Revenue agencies are not prepared to expand compliance programs to address pass-through entities
- Need to capture state K-1s not included in IRMF
- A more dedicated organization is needed to support a cradle to grave approach
- Identify data needed to support compliance programs and begin to move to more data driven audit selection
- Aggregation of audit results by partners and members
- Need for solutions that graphically illustrate and depict relationships
- How do the statute of limitations of entities and partners/members sync to assure ability to assess audited liabilities

References

- LARGE PARTNERSHIPS With Growing Number of Partnerships, IRS Needs to Improve Audit Efficiency GAO-14-732
- PARTNERSHIPS AND S CORPORATIONS IRS Needs to Improve Information to Address Tax Noncompliance GAO-14-453
- TAX GAP IRS Can Improve Efforts to Address Tax Evasion by Networks of Businesses and Related Entities GAO-10-968
- TAX GAP Actions Needed to Address Noncompliance with S Corporation Tax Rules GAO-10-195
- Despite Some Favorable Partnership Audit Trends, the Number of No-Change Audits Is a Concern TIGTA 2012-30-06020
- The Recommended Adjustments From S Corporation Audits Are Substantial, but the Number of No-Change Audits Is a Concern TIGTA 2012-30-062

Joseph Milack
jmilack@gentax.com
480.209.3498

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